

**MINUTES OF THE REGULAR MEETING OF THE
ARIZONA STATE RETIREMENT SYSTEM BOARD**

**HELD ON
Friday, August 18, 2000
8:30 a.m., MST**

The Arizona State Retirement System (ASRS) Board met in the 10th Floor Board Room of the ASRS office at 3300 North Central Avenue, Phoenix, Arizona 85067-3910. Dr. Chuck Essigs, Chairman, Arizona State Retirement System Board called the meeting to order at 8:29 a.m., MST.

The meeting was teleconferenced to the ASRS Tucson office, 7660 East Broadway Boulevard, Suite 108, Tucson, Arizona 85710-3776.

1. Call to Order; Roll Call; Opening Remarks

Present: Dr. Chuck Essigs, Chairman
Mr. Jim Bruner, Vice Chairman (arrived at 9:21 a.m.)
Dr. Merlin DuVal
Ms. Bonnie Gonzalez
Mr. Norman Miller
Mr. Karl Polen
Mr. Ray Rottas

Excused: Mr. Jim Jenkins
Mr. Alan Maguire

A quorum was present for the purpose of conducting business.

2. Approval of Minutes of the July 21, 2000 Regular Meeting of the Arizona State Retirement System Board

Motion: Mr. Ray Rottas moved to approve the minutes of the July 21, 2000 regular meeting of the Arizona State Retirement System Board.

Mr. Norman Miller seconded the motion.

Dr. Merlin DuVal pointed out an inconsistency in the number of members presence and the vote totals during the motion items.

Substitute Motion: Mr. Ray Rottas moved to approve the minutes, as corrected to reflect the accurate number of members present during the motion items, of the July 21, 2000 regular meeting of the Arizona State Retirement System Board.

Mr. Norman Miller seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, 3 excused, the motion was approved.

3. Board Approval of Consent Schedule

Motion: Dr. Merlin DuVal moved that the ASRS Board approve the summary report of Retirements, Refunds and Death Benefits; System Transfers; Applications and Agreements between the ASRS and the following Employers:

- (1) Benson Unified School District
- (2) Country Gardens Charter School
- (3) Multi-Dimensional Literacy Corporation – Desert Mosaic School

and the approval of contract extension for Watson Wyatt & Company for the actuarial services contract through June 30, 2001 with a fee increase of 3.75% over the current year and an extension for Buck Consultants for the health benefits consulting contract through June 30, 2001 with an increase in hourly rate from the current \$190 to \$225.

Mr. Norman Miller seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, 3 excused, the motion was approved.

4. Presentation, Discussion and Appropriate Action Regarding the Budget Board Committee Report

Ms. Bonnie Gonzalez, Chairman of the Budget Board Committee, reported that at the August 3, 2000 committee meeting, the ASRS staff presented a revised budget analysis and technology (IT) plan for the next fiscal years, providing additional information Board members had requested. The committee asked staff to downsize the number of proposed full-time equivalents (FTEs) to 32. The committee approved the staffing and IT plan and the budget proposal, which will be presented and voted on at a special Board meeting on August 29, 2000.

Mr. Ray Rottas asked how the 32 FTEs would be implemented.

Ms. Gonzalez reported that 20 FTEs, primarily IT and member services staff, would be added in the first year, with 12 staff added in the second year.

Dr. Chuck Essigs commended Ms. Gonzalez and other members of the Budget Board Committee for their work on the budget request and for producing a proposal that takes the ASRS in a good direction for the future.

5. Presentation, Discussion and Appropriate Action the Transition of Internally and Externally Managed Investments

Mr. Paul Matson, Chief Investment Officer, presented a transition plan for internally and externally managed investments to implement a strategy adopted by the Investment Review Board Committee (IRBC). At the May 9, 2000 IRBC meeting, the committee voted to recommend to the Board a reconfiguration of the internally managed investment allocation so that the internal stocks and bonds are approximately proportional to the total fund stocks and bonds.

Mr. Ray Rottas asked what the ASRS would accomplish by taking this action.

Mr. Matson responded that the objective of the IRBC is to diversify the internal weighting of stocks and bonds much like they are diversified externally.

Mr. Karl Polen commented that the current asset allocation (53 percent domestic equity, 17 percent international and 30 percent domestic fixed income) guides the policies of the Board. Two dimensions are looked at when implementing allocation strategy: active/passive management and internal/external management. The proposed changes are simply ways of implementing the asset allocation.

Mr. Rottas questioned whether the new policy is flexible or locked into certain ratios.

Mr. Polen said the policy would try to move internal management closer to the approximate ratio of the asset classes in external management, but does not require an exact ratio.

Mr. Matt Henderson, Assistant Portfolio Manager, discussed the viable options to reconfigure the internally managed investment allocation to match the overall fund investment allocation.

The ASRS staff recommended an in-kind transfer of internal equity assets (E1) into the BGI S&P 500 Index fund, and selling the BGI fixed income modules and the Duff & Phelps zero coupon portfolios for funding sources for a new fixed income portfolio. Staff considers the most appropriate ratio of U.S. equity stocks to U.S. bonds to be 53 percent to 30 percent.

Motion: Mr. Ray Rottas moved that the ASRS utilize Barclays Global Investors (BGI) services to reconfigure internally and externally managed investments such that internally managed equity and fixed income allocations match the overall fund allocation of approximately 53 percent equity to approximately 30 percent fixed income and that this be implemented while maintaining the current internal investment allocation. This

reconfiguration will be achieved by using the internally managed enhanced equity portfolio (E1) to fund the BGI S&P 500 index fund and in turn utilizing the BGI Lehman aggregate modules and Duff & Phelps zero coupon portfolio as funding sources for a newly created enhanced fixed income portfolio (F2).

Mr. Karl Polen seconded the motion.

Mr. Norman Miller asked Mr. Terry Dennison, Principal, Mercer Investment Consulting, if he had reviewed the recommendation.

Mr. Dennison replied that the recommendation of an in-kind transaction was both a sound and desirable strategy and essentially cost-free without exposing the fund to hidden costs.

By a vote of 6 in favor, 0 opposed, 0 abstentions, 3 excused, the motion was approved.

6. Presentation, Discussion and Appropriate Action Regarding the Total Fund Performance for the Period Ending June 30, 2000

Mr. Terry Dennison, Principal, Mercer Investment Consulting presented the ASRS Total Fund Performance for the period ending June 30, 2000.

Total Fund Performance for Periods Ending June 30, 2000

	Qtr	1 Year	3 Years	5 Years	10 Years
Total ASRS Fund	-1.5	10.0	15.9	17.0	14.3
Benchmark*	-1.6	7.6	13.7	15.4	13.0
TUCS Public Fund Median	-0.9	9.4	12.4	14.7	12.6

*1/1/89-12/31/91 is 60% S&P 500/40% LB Aggregate.

1/1/92-12/31/94 is 50% S&P 500/40% LB Aggregate/10% EAFE,

1/1/95-6/30/97 is 45% S&P 500/40% LB Aggregate/15% EAFE,

7/1/97-12/31/99 is 50% S&P 500/35% LB Aggregate/15% EAFE, and

1/1/00-Present is 53% S&P 500/30% LB Aggregate/17% EAFE.

Performance vs. Benchmarks for the 3 Years Ending June 30, 2000

	Return	Assumed ROR	Std. Dev.	Assumed Std. Dev.
Total ASRS Fund	15.9	9.3	12.5	10.2
Benchmark	13.7		11.1	
Domestic Fixed LB Aggregate	6.1 6.0	7.0	3.5 3.2	7.0
Domestic Equity S&P 500	19.8 19.7	10.2	18.8 17.8	16.2
Intl. Equity EAFE	16.0 10.5	10.6	21.8 20.4	19.7

Performance vs. Benchmarks for the 5 Years Ending June 30, 2000

	Return	Assumed ROR	Std. Dev.	Assumed Std. Dev.
Total ASRS Fund	17.0	9.3	10.5	10.2
Benchmark	15.4		9.4	
Domestic Fixed	6.3	7.0	4.2	7.0
LB Aggregate	6.3		3.5	
Domestic Equity	23.1	10.2	15.4	16.2
S&P 500	23.8		14.9	
Intl. Equity	14.7	10.6	17.7	19.7
EAFE	11.6		16.4	

Mr. Jim Bruner arrived at 9:21 a.m.

Mr. Ray Rottas asked what kind of returns might be predicted in the next year.

Mr. Dennison replied that the market is more volatile now than it has been historically and that there will probably be a period of significant uncertainty. He believes it will be difficult to find an asset class that will return over 10 percent and that the fund will not see the same returns as it has in the past.

Mr. Karl Polen requested an economic overview be presented at future Board meetings

7. Presentation, Discussion and Appropriate Action Regarding the Proposed Items for Discussion

Dr. Chuck Essigs asked Board members if they would like to comment on or discuss items that have been proposed for future Board discussion.

Mr. Karl Polen would like the Board, perhaps through the Investment Review Board Committee, to consider looking at the percentage of assets under management that are in value or growth strategies as a policy when implementing investment strategy.

Mr. Norman Miller asked if the ASRS newsletters report to members how the funds in defined contribution options employers offer, such as the state's deferred compensation plan, perform in comparison to the funds of the defined benefit plan of the ASRS.

Mr. LeRoy Gilbertson, Director, noted that there are far too many options offered by different employers on the state level to put that kind of comparison on paper. The ASRS is currently looking at plans that would offer some sort of match contribution as a supplement to a defined benefit plan.

Dr. Essigs suggested an analysis of existing options members of the ASRS currently have. The ASRS staff should look over all the proposed topics and schedule them for discussion at future Board meetings.

8. Director's Report

Mr. Tom Augherton, Deputy Director External Operations, reported that state law requires state agencies to submit their rules to the Governor's Regulatory Review Commission (GRRC) every five years. The ASRS contracted with an outside vendor, Kathleen Phillips, a former employee of the GRRC, to work with Mr. Fred Stork, Assistant Attorney General, Mr. Don Rohan, External Affairs, and Mr. Tom Finnerty, former Legislative Liaison. A review of the ASRS rules revealed the rules are not current, complete or in sync with some Board policies and decisions that have been made over the past 10 years. The report to GRRC identifies these deficiencies and omissions. The Board will be given the report and will be able to discuss how it would like the rules to read from a policy standpoint.

Dr. Merlin DuVal congratulated staff for going through each rule, identifying the inconsistencies and bringing them to the attention of the Board. He asked if it was possible for the ASRS to immediately identify the impact of a law might have on the rules so that the agency would not have to go through the review process every five years.

Mr. Fred Stork noted that the agency should be promulgating rules as statutes change, but it is still required to go to the GRCC every five years to report on the status of the rules.

Dr. DuVal inquired about the status of the new health insurance contracts that will become effective January 1, 2001.

Mr. Anthony Guarino, Deputy Director, Chief Operations Officer, reported that proposals have been submitted in response to the new Request-for-Proposal (RFP).

Dr. DuVal asked if any members will lose their coverage on January 1.

Dr. Chuck Essigs answered that the companies with current contracts have agreed to extend their contracts through March 2001.

Dr. Essigs commented that under the Employer's Reporting section of the Director's Report, it appears the ASRS has made significant improvement on getting employers to collect money and get it to the fund.

9. Board Requests for Agenda Items.

There were no requests for agenda items.

10. Call to the Public

There were no requests to speak from the Phoenix or Tucson public.

11. A special ASRS Board meeting will be held Tuesday, August 29 at 2:30 p.m. and the next regular ASRS Board meeting is scheduled for Friday, September 15, 2000, at 8:30 a.m. in the 10th Floor Board Room of the ASRS office at 3300 North Central Avenue, Phoenix, Arizona 85067-3910.

12. Adjournment of the ASRS Board.

Dr. Chuck Essigs, Chairman, adjourned the August 18, 2000 regular meeting of the ASRS Board at 10:12 a.m.

Respectfully submitted,

Maurah Harrison, Secretary

Date

LeRoy Gilbertson, Director

Date